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WHAT HAPPENED HUNGARY?

Political institutions and political economy dynamics before and after the 2010 authoritarian populist turn

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Abstract

The paper is concerned with the spectacular Hungarian democratic breakdown after 2010, focusing on political institutions and political economy dynamics the Orbán regime created. It argues that to understand what happened in Hungary after 2010, first we need to examine the unique system of political institutions of liberal democratic Hungary in 1990-2010 and the political economy equilibrium they generated. This was a highly centralized political system that produced stable governing majorities and institutionally insulated governments that, since the second part of the 1990s, have pursued increasingly populist economic policies. The result was, what the author calls, the political economy equilibrium of democratic populism that came to an end with the economic crisis and successive waves of fiscal stabilization in 2006-2010, wiping out two-third of the leftwing vote, and giving Viktor Orbán a two-third constitutional majority at the 2010 elections. Having become a constitutionally unconstrained leader, Orbán could then further centralize power and eliminate the system of checks and balances altogether, while creating the political economy equilibrium of authoritarian populism.

1. Introduction

Hungary was considered one of the most successful post-communist transition countries from the early 1990s until the mid-2000s. Following that, its comparative standing started deteriorating and in 2010, an authoritarian populist party attained constitutional supermajority in the legislature.[1] Since then, Prime Minister Viktor Orbán has been in power, altering the constitutional system and gaining re-election with two-third supermajorities both in 2014 and 2018. By now, Orbán can be considered one of the most successful democratically elected autocrats globally, who has been exercising close-to-unconstrained power for ten years in a member state of the European Union (EU). In terms of Freedom House rankings, Hungary was the worst performing democracy in the EU in 2019, a partly free country with an aggregate score of 70 out of 100, standing at pair with the Seychelles (71), Timor-Leste (70) and Tunisia (69).[2]

How has all this happened? How come that a country in the middle of Europe, a former star-performer of post-communist transition with functioning liberal democracy and market capitalism has endured such a spectacular decline in democratic standards? This paper tries to answer this question by focusing on aspects of transition that have distinguished Hungary from most other countries in Central and East Europe (CEE).[3] In particular, I will analyze the role of political institutions, arguing that they have to a

[1] By authoritarian populism I mean a political strategy that is based on a majoritarian approach to power, entailing a disrespect for the rule of law and minority political rights, while seeking democratic legitimacy, typically through elections. Hence, authoritarian populists are 'illiberal democrats' to use a term Viktor Orbán coined, but some have claimed to be an oxymoron (Kornai 2016) or, to say the least, puzzling (Kis 2018). Democratic populism, in turn, is not necessarily (although occasionally might be) hostile to the rule of law and other core liberal political values, while seeks to condition voters' behavior on fiscally unsustainable economic policies that typically imply large budget deficits and growing public indebtedness. Hence, both democratic and authoritarian populists extend government powers in problematic ways from a liberal democratic perspective. This differentiation is essentially identical with Rodrik's (2018a, 2018b) differentiation between economic and political populism. For related discussions, see Ádám (2018, 2020).

[2] The second worst performing EU country was Bulgaria with an aggregate score of 80. The EU average in 2019 was 91.2; the average of Central and East European post-communist EU member states was 85.9 (Freedom House 2019). Hungary's aggregate score has fallen spectacularly since Orbán's takeover as in 2010 it was 91. With the exception of Turkey, no other European country has experienced such a fall in aggregate score, while the only comparable drop among economically developed countries was that of Venezuela (Freedom House 2018, p. 10).

[3] If not otherwise indicated, I consider the CEE region as the 11 post-communist EU-member states: Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia.

large extent determined the result of political and economic developments both before and after 2010. These are considered 'institutional' in the Northian sense: as 'rules of the game' structuring social, political and economic interactions (North 1990).

The central argument of the paper is that the most important institutional factors enabling the spectacular authoritarian turn of the 2010s were the same as the ones enabling the remarkable political stability and economic development of the 1990s and 2000s. These included a highly centralized, Westminster model of democracy (Lijphart 1999) with exceptionally strong institutional safeguards protecting government stability and an effectively majoritarian, highly distortionary electoral system. Economic policies reinforced the rule of political elites in both periods: they solidified the positions of an autonomous political elite that did not depend on domestic economic stakeholders in the liberal democratic period, and helped create and maintain an even more dominating, institutionally unchallenged, hyper-hierarchical power structure with an extensive economic clientele among domestic business elites after 2010.

Moreover, unsustainable economic populism was a primary source of political legitimation in the liberal democratic period. Policies were shaped by the principles of privatization, liberalization and hard budget constraint (Kornai 2001), but those who lost their jobs and experienced a dramatic drop in the valuation of their skills were compensated through social policy schemes and could become economically inactive. Taxation of labor income was strongly progressive with super high marginal tax rates: the average tax wedge, consisting of personal income tax, payroll taxes and social security contributions, was among the highest in the OECD.

This was the political economy equilibrium of democratic populism that was associated with high budget deficits and rising public indebtedness that became fiscally unsustainable during the crisis of 2006-2010. What replaced it was the political economy equilibrium of authoritarian populism that introduced a flat income tax (hence steeply cutting middle and upper-middle class income taxes), reduced budgetary redistribution in general and spending on social benefits in particular, and kept the budget on a sustainable – although still pro-cyclical – trajectory. Employment increased, first on extensive public works programs and subsequently on growing demand on European labor markets amidst a post-crisis recovery. Wages grew and the incidence of poverty decreased from the mid-2010s, albeit income inequalities rose, reaching substantially higher levels than in the pre-2010 period. Hence, post-2010 authoritarian

populism has been characterized by pro-rich, pro-business policies that have been pursued alongside a dramatic deterioration of democratic standards, resulting in the elimination of the system of checks and balances, undermining core EU values and dissolving the rule of law.

By describing the dynamics of alternating populisms, the paper contributes to the evolving political economy of populism literature (Algan et al. 2017, Gidron and Hall 2017, Guiso et al. 2017, Gennaioli and Tabellini 2018, Fetzer 2019) with an emphasis on institutions. I follow the approach of Rodrik (2018a, 2018b), who differentiates between 'economic' and 'political' populisms, but call these 'democratic' and 'authoritarian' instead, to highlight the distinction between pre-2010 liberal democracy and the democratically legitimized, yet increasingly authoritarian post-2010 regime.

The paper also joins the debate on the political economy of the Orbán regime that has been conceptualized in neo-Marxist terms as an 'accumulative state' operating on behalf of a 'revolting national bourgeoisie' against global capitalism (Scheiring 2019) and as 'authoritarian neoliberalism' resulting from the 'inherent contradictions of neoliberal state capitalism' after the 1989 regime change (Fábry 2019). These accounts emphasize the role of domestic capital that aligns with (while at the same time being controlled by) the authoritarian populist regime to push back against transnational capital and to dominate over domestic labor and welfare recipients. This literature is right to highlight the role of middle and upper-middle class segments of society in cementing the authoritarian populist regime, but does not explain why the 'national bourgeoisie' has been willing to accept the dismantling of checks and balances and the institutionally unconstrained power of government that, after all, has weakened their property rights (Ádám 2019). In fact, rightwing conservative pushbacks against welfare states have been present in a wide range of democracies in past decades but they have not typically aligned with an explicitly anti-liberal, authoritarian populist political cause.[4] Hence, the gravity of democratic decline makes Hungary a unique case, even

[4] Historically, rightwing conservative elites pushing back against progressive social policies have, of course, exhibited authoritarian tendencies and allied with explicitly authoritarian political forces. Obvious examples include the decline of the Weimar Republic and the rule of General Pinochet in Chile. Contemporary conservatives, however, rarely align with explicitly authoritarian parties in relatively advanced democracies. In contrast, autocrats tend to give social concessions to middle and lower-middle classes, while mobilizing against the rich. This is, in fact, a typical policy stance and political strategy of rightwing authoritarian populists (Norris & Inglehart, 2019), and the Orbán regime has been no exception: It has mobilized

within the CEE region – a part of the world with relatively short democratic history, weak institutions and high salience of anti-democratic populism (Ágh 2016, Cianetti et al. 2018, Hanley and Vachudova 2018, Rupnik 2018, Bochsler and Juon 2019, Havlik 2019, Santana et al. 2020, Toplišek 2020).

To understand the complete breakdown of Hungarian liberal democracy and the overwhelming success of authoritarian populism, I argue, one first needs to examine the institutional structure of post-1990 Hungary and its post-2010 evolution. Only in light of the effectively majoritarian electoral system, the highly centralized model of democracy and the political economy dynamics they generated both before and after 2010 can one explain what happened in Hungary in past decades.

In the rest of the paper, I first present the post-1990 Hungarian political system and its post-2010 transformation, demonstrating how different it has been from any other political systems in CEE. Secondly, I discuss the political economy dynamics these institutions set into motion both in the liberal democratic and the authoritarian populist periods. Finally, I draw conclusions.

2. The post-1990 Hungarian political system in comparative perspective

The new Hungarian democratic political system was created at the roundtable talks of 1989 between representatives of the newly emerging opposition parties and the dissolving communist regime (Bozóki 2002). During the talks, the communist party was still considered to be the dominant political force, while the fragmented opposition sought to create opportunities for electoral collaboration among themselves. Opposition parties also believed that direct, locally embedded communication between voters and representatives was instrumental to democratic development. The communists, relying on an extensive national party organization, essentially agreed. Hence, a mixed electoral system containing both single member constituencies (SMCs) and party lists with a mechanism of compensation for losers in SMCs was created. Election in SMCs was two-round with the strongest 3-4 candidates making it to run-off, if no candidate

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against multinational companies, banks, financial investors, the IMF, the European Commission, and George Soros, while it has given economic concessions to middle and lower-middle class households (Szikra, 2014; 2018). One characteristically anti-capitalist / anti-multinational policy has been forcing utility companies to cut retail prices since 2013 (LaBelle & Georgiev, 2015; Szép & Weiner, 2020), resulting in a major boost in popularity for the regime before the 2014 elections.

received an outright majority in the first round. Essentially, this was a mixture of the German and French electoral systems with which the founding fathers of the post-1990 liberal democratic regime sought to create strong governing majorities and to avoid the 'Weimarization' of the republic.

The new electoral system was not only dominantly majoritarian, but also contained high barriers of entry. So that a party could receive votes for its county-level party lists and its national compensatory list, it had to field a certain number of SMC candidates. Fielding an SMC candidate, in turn, was conditioned on collecting 750 recommendations from voters living in the particular district – quite a high effective threshold for smaller parties not having nation-wide party organizations.[5]

The legislature was unicameral with no upper house, and the prime minister bore sole responsibility for the entire government (i.e. there could be no no-confidence votes against individual cabinet members). The only way to dismiss the prime minister was through the so-called constructive no-confidence vote (adopted from the German constitutional system), implying that only if a new prime minister was elected by the very same vote could be the old one replaced by parliament.

The semi-strong president of republic (supreme commander-in-chief of the army with considerable veto powers but with no substantial foreign or domestic policy roles) was initially to be elected directly by voters – a preference of the communists, who had a few well-known and relatively popular leaders with a national profile back in 1989-1990. However, the less compromising part of the opposition – the Liberals – altered this scheme through a referendum in November 1989 to prevent the election of a communist president of republic. As a result, Hungary ended up as one of the few countries in Europe with a president of republic elected by parliament.[6]

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[5] Voters could recommend only one candidate.

[6] Although originally first Czechoslovakia and from 1993 both the Czech Republic and Slovakia had their presidents elected by legislatures, subsequently both of them adopted direct presidential elections. Currently, there are 7 EU member states with indirectly elected presidents of republic: Estonia, Germany, Greece, Hungary, Italy, Malta and Latvia. There are 7 monarchies (the Belgium, Denmark, Luxemburg, the Netherlands, Spain, Sweden and the UK) and 14 member states with directly elected presidents (Austria, Bulgaria, Croatia, the Cyprus, Czech Republic, Finland, France, Ireland, Lithuania, Poland, Portugal, Romania, Slovakia and Slovenia). In addition, there are three European countries outside of the EU with indirect presidential elections: Albania, Armenia and Switzerland. Altogether, out of 41 European countries, there are 8 monarchies, 23 republics with directly elected presidents and 10 republics with indirectly elected presidents. The trend towards direct presidential vote is not secular, however: Armenia, interestingly, has recently switched from direct to indirect presidential election.

Table 1 about here

The fear from a directly elected president was not only that a (former) communist president could expand the lifespan of the ancient regime, but also that a directly elected president could stage a constitutional coup, relying on the broad political legitimacy the post carries. Given the high number of relevant historical examples from Napoleon III (1852) through Juan Peron (1946) to Alberto Fujimori (1990), such concerns were not unfounded. However, by eliminating the post of a directly elected president, the new Hungarian democracy also got rid of an institutional mechanism through which opposition parties and movements could relatively easily challenge a government with authoritarian tendencies. Such a mechanism has been implemented by opposition parties and civil society movements in CEE, including Bulgaria (2016), Romania (2014, 2019) and Slovakia (2004, 2014, 2019) that have had all elected opposition presidents in past decades. This is because a fragmented opposition, typically at massive financial and organizational disadvantage to governing parties, were more likely to get a single person elected in a high profile national election than winning more complex parliamentary elections. In other words, collective action is more likely to succeed if coordination needs are lower and expected pay-offs are higher and more realistic (cf. Olson 1965).

As Olson (1993) has also argued, the most important historical condition for the emergence of democracy is that no political actor can exercise unlimited power. The multiplicity of elections, including presidential, parliamentary and regional elections, and the resulting overlap of political authorities, each relying on rival political legitimacies, can play instrumental role in this. The drama of the post-2010 Hungarian democratic decline to a large part results from the fact that the post-1990 Hungarian political system neither had overlapping political authorities nor a multiplicity of nation-wide elections. The majority of the unicameral parliament could control all significant state-administered political resources. The only partial exception was the post of the Budapest mayor; a directly elected official since 1994 that were at times controlled by the opposition and could offer some political competition to the central government by representing a degree of national-level political authority. However, when governing parties obtained a two-third constitutional supermajority in parliamentary, as in 1994-

1998 and after 2010, they could exert unlimited power over the entire political system, including both political and administrative resources, eliminating practically all institutional constraints on their actions.[7]

This has been in sharp contrast to the practice of other CEE countries. In the past 15 years, populist leaders have taken over premierships across the region, including the Czech Republic (Andrej Babis, since 2017), Poland (various premiers of the ruling Law and Justice Party in 2005-2007 and since 2015), Slovakia (Robert Fico, 2012-2018) and Slovenia (Janez Jansa, 2004-2008, 2012-2013 and since 2020). Both the Czech Republic and Poland have elected populist presidents directly (Milos Zeman and Andrzej Duda, respectively), who were both supported by the governing populists. Yet, neither the Czech Republic, nor Poland, nor any other country in the region have experienced a democratic decline comparable to that of Hungary. Although populist governments have often attacked the system of checks and balances and – particularly in Poland and Romania – sought to undermine the independence of the judiciary, nowhere did they succeed in the complete dismantling of the rule of law. The proportional electoral systems that, with the partial exception of Lithuania, function across the region, did not allow for any other governing coalitions to obtain a constitutional supermajority.[8]

The power-centralizing effect of the Hungarian electoral system is demonstrated by the fact that Hungary has had the lowest numbers of parliamentary parties and new parliamentary parties in CEE in the past three decades (Figure 1). In addition, the Hungarian electoral system has been also characterized with an extreme measure of disproportionality benefitting large parties that could have a chance of winning SMCs. This effect is captured by the Gallagher index that measures the discrepancy between votes cast for and parliamentary seats gained by political parties.[9] Based on average

[7] Realizing this, the Socialist-Liberal governing coalition of 1994-1998 voluntarily introduced a new provision that required a four-fifth majority of parliament to initiate a change of constitution. The two-third Fidesz supermajority after 2010 eliminated this provision with a two-third vote.

[8] The only exception to this, to my knowledge, is the current Slovakian governing coalition that was formed following the February 2020 elections, and that controls more than two-third of parliamentary seats.

[9] A measure of disproportionality between vote and seat distributions according to the Gallagher "Least Squares Index" for all parties in general election, defined as $\sqrt{\frac{1}{2}\sum_{i=1}^{m}(v_i - s_i)^2}$, where v_i is the percentage of votes obtained by i^{th} party and s_i is the percentage of seats obtained by i^{th} party.

data for 1990-2016, Hungary had the most disproportionate electoral system in CEE and, in fact, one of the most disproportionate ones worldwide (Figures 2-3).

Figures 1-4 about here

Electoral disproportionality implies that some part of the electorate are underrepresented whereas others are overrepresented in the legislature. This is a characteristic of most (albeit not all) majoritarian electoral systems that prefer larger parties over smaller ones. In fact, virtually all high Gallagher index values are observed in countries with majoritarian electoral systems, although national characteristics play important role.[10] On the other hand, misrepresentation of electoral preferences has been associated with diminishing representative capacity of traditional parties; a development often identified as an explanation for the rise of populism in the literature (Kriesi 2014, Mair 2002, Mair 2000). The rising electoral performance of populist parties constituting a systemic alternative in a number of high Gallagher index countries, such as France, Hungary, the Philippines, Turkey, and the UK in the past three decades appear to reinforce this point. In the particular Hungarian context, the systemic alternative was represented by Jobbik, a classic radical right party established in 2003, that became the third largest party by the late 2000s (Ádám and Bozóki 2016).[11]

Having been reelected at the 2006 election on a program of tax cuts and rising regional transfers primarily financed from EU development funding, the center left Socialist-Liberal coalition lost credibility within months of their electoral victory. First, the government was forced to adopt stabilization policies to correct an unsustainable

[10] Lithuania has a partially majoritarian electoral system, although less so than Hungary. Albania and Macedonia used to have predominantly majoritarian systems until 2009 and 2002, respectively, but have subsequently shifted to proportional representation. The Philippines, Taiwan and Thailand have mixed systems with dominant majoritarian elements. Canada, France and the UK have clear majoritarian systems (singe round first-past-the-post systems in Canada and the UK and a two round run-off system in France). Turkey has a proportional system with 10% electoral threshold that excludes most of the smaller parties from representation. At the same time, the US with a purely majoritarian first-past-the-post system ranks notably low on the Gallagher index, probably due to the primary system that sufficiently expands the electoral appeal of the two major parties.

[11] Since the mid-2010s, Jobbik has changed electoral strategy, considerably moderating its political stance, and effectively swapped places with formerly center-right Fidesz that has meanwhile navigated towards the radical right pole of the political spectrum. On the rise of Jobbik as a major rightwing-radical political party, see Pirro and Róna (2018). On programmatic interactions between Fidesz and Jobbik, see Enyedi and Róna (2019).

fiscal trajectory in 2006-2007,[12] followed by a lost a referendum on co-payments in public health care and tuition fees in public universities in spring 2008. Then came the global financial crisis in fall 2008, and Hungary was the first EU member country to ask for official financing from the IMF and the EU that was granted at conditions of further austerity.

At the 2010 elections, Fidesz gained 53% of the popular vote, while Jobbik received another 17%.[13] Hence, the combined rightwing opposition vote was well above two-third. Yet, having won the overwhelming majority of SMCs, Fidesz was able to form a two-third constitutional majority of parliament on their own. This was a decisive moment in the history of Hungarian democracy: from this point onwards, using their constitutional majority, Fidesz have dismantled the system of checks and balances, effectively suspended the rule of law, and created deeply uneven conditions for further elections.

The share of SMCs within the overall number of parliamentary seats increased from 46% to 53%, strengthening the majoritarian character of the electoral system. The two-round, French-type system was turned into a UK/US-type single-round first-past-the-post system, eliminating intra-party cooperation between the two election rounds and hence making opposition cooperation more difficult and potentially more costly in case of ideological divergence among participants.

Another important change was an effective cut in the parliamentary threshold by two means: registering individual candidates in SMCs became easier, while county-level party lists were replaced with a single national list. This might seem as steps toward growing inclusiveness of the electoral system, but the actual rationale was splitting the opposition vote and preventing the emergence of a main opposition contender that could effectively challenge Fidesz. Finally, the mechanism of electoral compensation was also changed to the benefit of Fidesz, favoring not only the parties of losing SMC candidates but also the winner party that receives the vote difference between the winning candidate and his/her closest rival to their national list. All this implied a further increase in disproportionality of the electoral system, demonstrated by

[12] "We lied day and night" said Prime Minister Gyurcsány to his fellow Socialist members of parliament in a secret post-election speech that sought to stir support for an ambitious program of reforming public finances. The speech was leaked before the fall 2006 local elections and riots broke out on Budapest streets.

[13] The Socialists received 19%, while the Liberals did not contest the elections. Another 7% was picked up by a new centrist-green party.

a rising Gallagher index value from 2014 (the first election held under modified rules) (Figure 4).

Assisted by heavy government propaganda, occasional intimidation, widespread clientele building and economic nationalism, Fidesz received 45 and 49 percent of popular votes at the 2014 and 2018 elections, respectively. Under the new electoral rules this was at both times sufficient to attain two-third constitutional majorities in parliament, hence to reproduce the institutional basis of practically unconstrained authoritarian populism. In effect, Hungary was transformed from a many ways flawed but functioning pre-2010 liberal democracy into a popularly legitimized post-2010 semi-autocracy. The shift was made possible by a disproportional electoral system that generated a single-party two-third majority in the unicameral parliament that, from that point onwards, has been able to alter any constitutional provisions.

The immediate political reason for the overwhelming rightwing electoral dominance was the dramatic loss of credibility by the center-left governing coalition that had been reelected on an economic populist ticket in 2006, but was unable to deliver on this in the crisis-ridden 2006-2010 years. Hence, rationally enough, the governing Fidesz in power offered a considerably different political economy equilibrium.

3. The political economy equilibria of democratic and authoritarian populism

Democratic and authoritarian populist regimes in pre- and post-2010 Hungary, respectively, generated dramatically different political economy dynamics, while relying on similar, although not identical political institutions. In the following two subsections, I describe the political economy equilibria of both periods. To start with, I report the most relevant macroeconomic indicators, using three regional benchmarks, in Table 2. This is followed by discussions of political economy dynamics, focusing on economic reforms, labor market developments and fiscal trajectories.

Table 2 about here

3.1. The political economy of democratic populism

Hungary had been one of the reform vanguards of CEE in the first 10-15 years of post-communist transition. According to the London-based European Bank for Reconstruction and Development (EBRD) that has been evaluating performance in economic transition since 1989, Hungary has been consistently one of the most advanced countries in most institutional dimensions. For the period of 1989-2014, the EBRD assessed 6 aspects of economic transition: (1) large scale privatization, (2) small scale privatization, (3) governance and enterprise restructuring, (4) price liberalization, (5) trade and foreign exchange system, and (6) competition policy. According to this, Hungary was an early riser, scoring high on all 6 dimensions by the mid-1990s (Figures 5-10).

Figures 5-10 about here

Notably, in the early 1990s, Hungary delivered the relatively least impressive performance in small scale privatization. This could have been the result of less political attention paid to small enterprises in an already relatively liberalized political and economic context at the beginning of transition. However, it could also result from the fact that Hungarian policy makers were to a large extent insulated from interest groups, who in this particular case would primarily be managers and employees of state-owned firms. Instead of delivering towards them, policy makers preferred to concentrate on large scale privatization and improve competition policy from early on. Hence, in contrast to many other post-communist countries, Hungary did not introduce either voucher privatization or extensive employee ownership, and/or management buy-out schemes. Instead, the broad political consensus was to manage state assets centrally and sell state-owned companies to new owners for actual money, even if it took longer than the simple give away of firms could. Taking the high foreign indebtedness of Hungary and the potential efficiency gains from external ownership into consideration, this approach was rational both on a general economic basis (Mickiewicz and Baltowski 2003, Djankov and Murell 2002) and within the particular Hungarian political economy context (Ádám 2004).

In contrast to small scale privatization, Hungary was a top performer in virtually all other institutional aspects of transition, performing the process János Kornai (2001)

labeled 'hardening of the budget constraint'. Kornai's argument referred to his earlier work on the prevalence of 'soft budget constraint' in communist economies by which he meant budgetary transfers and various forms of subsidies provided for state-owned firms at soft political conditions (Kornai 1980). Post-communist economic transition in an institutional sense, he argued, was about hardening the soft budget constraint: severing the close relation between the state and business entities and let them to be exposed to market dynamics. As Kornai (2001) showed, Hungary was a forerunner in this process, forcing a high number of inefficient firms out of business in the 1990s through introducing a harsh bankruptcy law, stringent bank regulation and privatization of banks and enterprises for external owners (Mihályi 1996).

Apart from having had to raise privatization revenues, the tough Hungarian market approach to economic transition was also explained by the Washington consensus; the economic policy zeitgeist of the 1990s that required fiscal balance, low inflation, competitive exchange rates, and market deregulation. If all this happened, went the policy prescription, economic activity should have soon picked up, and the 'creative destruction' of early transition, typically entailing a period of transformational recession (Kornai 1994), should have been followed by sustainable economic growth and rising employment. This was only partially realized in CEE, though. Although economic growth indeed picked up in a few years, employment loss of the early transition years in most CEE countries did not recover for about two decades.

Hungary was particularly hard hit by the employment catastrophe. In 1989-1998, the number of economically active people fell by 1.2 million, whereas the drop in overall population was 120 thousand. The rate of employment decreased by about 10 percentage points. Although other CEE countries – Estonia, most notably – experienced similar or even harsher drops in employment, the Hungarian employment rate remained very low for a protracted period (Figures 11-12).

Figures 11-14 about here

One can identify at least four interrelated factors behind the weak Hungarian labor market performance during transition. (1) First, amidst the vast economic changes, many lower educated, older workers' skillset became obsolete. The newly established, export-oriented manufacturing firms typically implemented technologically more

advanced, less labor-intensive production that needed fewer but better educated workers. (2) Secondly, the growth capacity of the locally based, technologically less intensive small and medium size enterprises turned out to be limited. And as wages started rising after 2000, due to aggressive minimum wage hikes by both rightwing and leftwing governments, labor-intensive industries got priced out from the market (Kertesi and Köllő 2003). (3) Thirdly, economic policy makers believed that it was not worthwhile to invest in the skillset of older, less educated workers. It seemed to be a simpler, safer, and economically more rationale policy choice to let these people off the labor market through early retirement and disability pension schemes, or to provide them with modest social benefits as long-term unemployed. (4) Fourthly, in case of the Roma, Hungary's largest ethnic minority with about 3-7 percent of overall population, low skill levels coincided with negative labor market discrimination, further deteriorating the chances of formal employment (Kertesi and Kézdi 2011). In sum, Hungary ended up with a particularly low employment rate of unskilled workers (Köllő 2015), considerable shrinkage of the labor force, massive extension of informal employment, and a particularly low rate of economic activity. As the economically inactive were financed through fiscal transfers, budgetary redistribution and spending on social protection, in consequence, stayed high (Figures 13-14). This was the basis of the pre-2010 democratic populist political economy equilibrium that was associated with large, recurring fiscal deficits and high – and since 2002- steeply rising – public debt. In the wake of the fiscal stabilization of 2006-2007 and the global financial and economic crises of 2009-2010, however, this political economy equilibrium was no longer tenable.

3.2. The political economy of authoritarian populism

When Fidesz came into power in 2010 obtaining a two-third constitutional majority in parliament, they implemented a set of fundamentally different economic policies than the ones of the previous period. These new policies of the 2010s made up what I call the political economy equilibrium of authoritarian populism. This consisted of increasing government controls and interventions, preference for domestic capital over foreign direct investments, extensive clientele building, reduced spending on social protection, a flat income tax, a much more balanced and sustainable fiscal trajectory, rising employment and growing (yet still relatively modest) income inequalities.

As fiscal stabilization had been essentially carried out in 2009-2010 and economic growth resumed in Q2 2010, the new Fidesz government had a substantially larger policy space than its predecessor. With rising EU development funding[14] and an increasingly discretionary public procurement policy framework (Tóth and Hajdu 2018), they could also allocate considerable resources for building an extensive business clientele while maintaining fiscal sustainability. In addition, due to the re-nationalization of the mandatory private pension system, the government obtained extra social security contributions, and was able to cancel a part of outstanding public debt (Simonovits 2011).

Since 2010, a number of companies and banks have been nationalized, many of them to be subsequently reprivatized for friendly businesses (Mihályi 2014, Voszka 2018). In the national champion oil company, the government bought and retained a controlling stake. Some public utility companies were bought back from foreign owners by local authorities with government support. In (at least partly) non-tradeable service industries, such as construction, energy and retail sales, large domestically owned companies were built by government-sponsored private business groups (Ádám 2019).

The patterns of taxation and budgetary redistribution have been radically altered. An already low level of corporate taxation was further eased, while special taxes were levied on banks and multinational companies in selected service industries to trigger market exit by unwanted foreign competitors. A flat income tax was introduced that delivered a large income tax cut in the uppermost income quintile, while – at least for a while – also reducing direct taxation in the next three income quintiles (Figure 15). In turn, the general rate of the value added tax was raised to 27% (the highest in the EU and the OECD), primarily placing additional tax burden at the lower end of the income distribution scale where the consumption/income ratio was always the highest.

Spending on social protection was reduced, with overall budgetary redistribution has been decreasing since 2016. As a major part of the new social policy regime, an extensive public works program was implemented that at its peak employed two hundred thousand people in a labor market of less than four million. Conditionality of social benefits on participation in public work programs was strengthened contributing to the rise in employment of unskilled labor (Figure 16).

[14] Incoming EU funds amounted to 3-5% of gross national income throughout the 2010s.

Social policies have become increasingly restrictive and less welcoming towards the poor (Szikra 2014, Scharle and Szikra 2015). The incidence of poverty increased in the first part of the 2010s, but has subsequently declined on expanding low-skill employment and rising wages amidst a post-crisis European recovery. (As Hungarian workers have increasingly left for Western European labor markets, a shortage of labor emerged that pushed wages upward.) Meanwhile, income inequalities measured by the Gini coefficient rose from 24.1% in 2010 to 28.7% in 2018 (Figures 17-18).

Figures 15-18 about here

Although the overall fiscal policy stance remained pro-cyclical amidst the post-crisis upturn of the European business cycle, annual general government deficits stayed moderate and the government's consolidated gross debt in percent of GDP gradually decreased. In consequence, and in contrast to the pre-2010 period, the fiscal trajectory of the 2010s has been sustainable from a point of view of short term financing, although the stock of implicit public debt has risen on the nationalization of mandatory private pension funds (Figures 19-20).

Due to a markedly weak domestic currency, maintained through low policy rates by the central bank, the external financing capacity (the combined sum of the current and the capital account) has remained positive throughout the entire decade. Meanwhile, economic growth has picked up since 2013 and has outperformed the region. Nevertheless, growth appears to have followed a political business cycle through politically controlled investment dynamics, optimized to elections (Figures 21-24).

Figures 19-24 about here

In sum, the fiscally unsustainable political economy equilibrium of democratic populism, characterized by extensive social spending, high income taxes and a large degree of pro-poor redistribution, was replaced by much more balanced and sustainable, less redistributive, and in important aspects pro-rich fiscal policies in the authoritarian populist period. Whereas foreign direct investors played a primary role in economic modernization before 2010, domestic capital – organized into government-controlled economic clienteles – has been the politically preferred type of economic actors in

authoritarian populism. Government discretion and intervention grew, while restrictive social policies and an extensive public works program contributed to rising employment. The economic success of authoritarian populism was also assisted by the fiscal consolidation of 2009-2010, the European post-crisis recovery of the 2010s and a large amount of incoming EU funds. Generating a new political economy equilibrium, custom-suited to institutionally unconstrained power and the primary role of politically controlled economic clienteles, Viktor Orbán's authoritarian populist regime could consolidate itself and reproduce its two-third constitutional majorities at two consecutive elections.

4. Conclusions

This paper analyzed the decline of Hungarian democracy focusing on institutions and political economy dynamics. It argued that the emergence and subsequent consolidation of Viktor Orbán's authoritarian populist regime in the 2010s has been intimately linked to the unique Hungarian system of political institutions in the liberal democratic period. Most prominently, this consisted of a predominantly majoritarian electoral system and a Westminster model of democracy that enabled Orbán's absolute takeover in 2010. Once a two-third constitutional majority in parliament has been obtained, no one could resist the will of the governing majority and the fate of Hungarian liberal democracy was doomed.

Yet, this is not the entire story of Hungarian de-democratization during the Orbán regime. As the Westminster model of democracy had centralized power and insulated governments from short term interests of economic stakeholders since the early 1990s, the policies of post-communist transformation drove out about one-fifth of the labor force – mainly older and unskilled workers – from formal employment by the end of the first transition decade. With a dramatic drop in economic activity, fiscal transfers to pensioners and the long term unemployed rose, while income taxes and social security contributions stabilized at a very high rate. This was the political economy equilibrium of democratic populism, in which technologically advanced multinational companies and foreign banks played a dominant economic role, while labor-intensive domestic firms lagged behind. This equilibrium came to an end in the crises of 2006-2010, when the fiscal trajectory became untenable and the newly re-elected center-left coalition was forced to carry out harsh stabilization policies.

Following Orbán's 2010 takeover, an authoritarian populist political economy equilibrium has been introduced. Income taxes of middle and upper-middle classes have been dramatically slashed, social benefits of the long term unemployed curtailed and incentives for engaging in formal employment relations, including public works programs, enhanced. The fiscal balance has been kept on a sustainable trajectory despite a pro-cyclical policy stance and a rise in implicit public debt. With intensified government interventions and extensive economic clientele building, redistributive preferences have been given to middle and upper-middle classes that, in turn, have politically reinforced the regime. Along with nationalism, coercion and politically selective social benefits, these policies have played a vital role in cementing the regime.

As the authoritarian populist political economy equilibrium was based on highly selective and fiscally sustainable policies, the Orbán regime has enjoyed considerable policy scope and has managed to adjust to changing external economic circumstances since its inception. With very few exceptions, these external economic circumstances had been benevolent throughout the 2010s. However, this might be about to change due to a global recession in the wake of the Covid19 epidemic as well as a more restrictive EU policy stance on financing democratically non-complying member states. How the Orbán regime will react to a period of hardship, if it comes around, is yet to be seen.

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Table 1. Selected institutional characteristics of CEE political systems

	Legislature	Parliamentary elections	Threshold	Presidential election	Constitutional amendment	Constitutional majority held by government
Bulgaria	Unicameral	Proportional	4%	Direct	3/4 of Parliament	-
Croatia	Unicameral	Proportional	5%	Direct	2/3 of Parliament	-
Czech Rep	Bicameral	Lower Chamber: Proportional Upper Chamber: Majority	5% for the Lower Chamber	Direct	3/5 in both the Lower and Upper Chambers	-
Estonia	Unicameral	Proportional	5%	Indirect	3/5 plus referendum, or simple majority + 3/5, or 4/5 plus 2/3*	-
Hungary	Unicameral	Mixed, dominantly majoritarian	5% for seats elected proportionally	Indirect	2/3 of Parliament	1994-1998, 2010-2014, 2014-2015, 2018-present
Latvia	Unicameral	Proportional	5%	Indirect	2/3 of Parliament**	-
Lithuania	Unicameral	Mixed, 71:70 majority-proportional	5% for seats elected proportionally	Direct	2/3 of Parliament twice***	-
Poland	Bicameral	Lower Chamber: Proportional Upper Chamber: Majority	5% for the Lower Chamber	Direct	2/3 of Lower Chamber and simple majority of Upper Chamber****	-
Romania	Bicameral	Proportional	5%	Direct	2/3 of Lower and Upper Chamber each or 3/4 of a joint session*****	-
Slovakia	Unicameral	Proportional	5%	Direct	3/5 of Parliament	-
Slovenia	Bicameral	Proportional	4%	Direct	3/5 of Parliament******	-

Sources: National authorities, https://www.constituteproject.org

* In Estonia, there are three ways of amending the constitution: (1) by a referendum; (2) decisions by two successive Parliaments; (3) by the Parliament, as a matter of urgency. (1) 3/5 of Parliament is required to submit a bill to amend the constitution by a referendum. Some parts of the constitution can be only amended by a referendum. (2) In order to amend the Constitution by two successive Parliaments, a bill to amend the constitution must be supported by a majority of the first Parliament and 3/5 of the

second. (3) To amend the constitution as a matter of urgency first 4/5 of Parliament have to agree with the procedure and 2/3 of Parliament in a successive vote with the amendment itself.

** Amendment of some articles need to be also approved by a referendum. 1/10 of the electorate can propose the Parliament to amend the constitution. If the Parliament does not agree, the proposed amendment goes to referendum.

*** There must be at least 3 months between the two parliamentary votes. Some parts of the constitution can be only amended by a referendum.

**** Some amendments may require a confirmatory referendum that is ordered by the speaker of the Lower Chamber.

***** The amendment needs to be approved by a referendum.

****** Amendment through referendum is possible upon the proposal of 1/3 of the Lower Chamber.

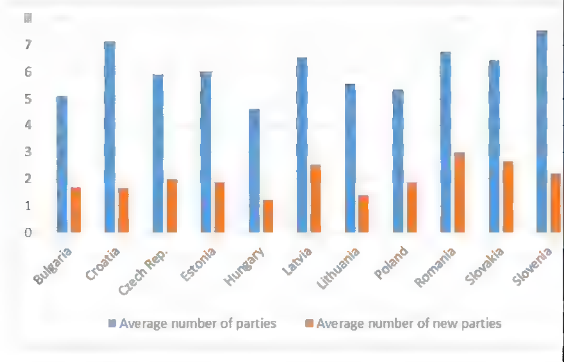
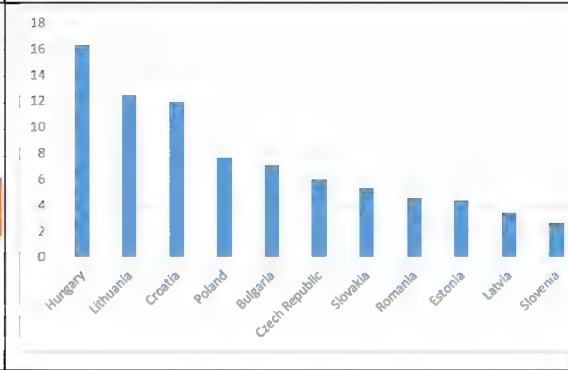
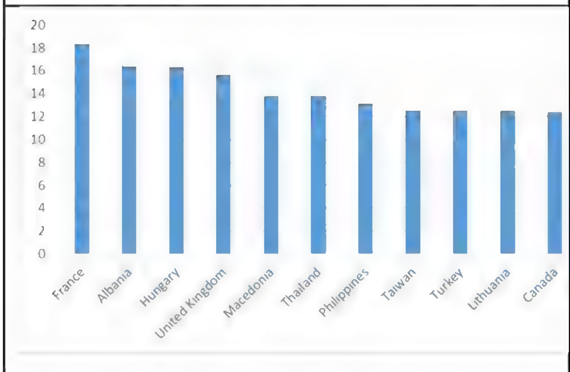
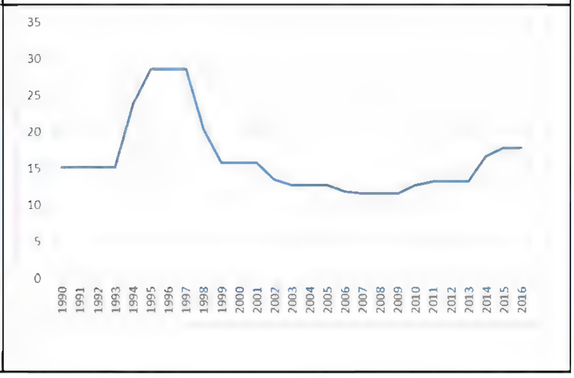
Table 2. Selected economic indicators in Hungary and Central and Eastern Europe in the pre- and post-2010 periods

	Economic growth	Budget balance, headline	Budget balance, primary cyclically adjusted	General government spending	General government spending on social protection	Government consolidated gross debt	Employment rate	Low skill employment rate	Average working life	Poverty rate	Current account	Net FDI stock
	yoy, percentage	in % of GDP	in % of potential GDP	in % of GDP	in % of GDP	in % of GDP	in % of working age population	in % of 15-64 years old	in years	in % of population	in % of GDP	in % of GDP
Average pre-2010	1996-2010	1995-2010	1995-2010	1995-2010	1995-2010	1995-2010	1992-2010	2005-2010	2000-2010	2000-2010	2000-2010	2000-2010
Baltic3	4.6	-1.8	-0.6	37.6	11.4	13.9	54.9	48.8	33.5	19.6	-7.6	33.3
CE4	3.7	-4.3	-2.2	44.6	15.1	32.4	52.7	41.8	32.4	12.4	-3.8	31.1
SE3	2.7	-2.6	0.1	39.2	11.8	35.3	51.1	47.7	31.4	19.4	-7.9	35.9
Hungary	2.4	-6.0	-0.9	49.8	16.1	64.8	46.4	37.5	28.3	12.3	-6.2	46.3
Average post-2010	2011-2018	2011-2018	2011-2018	2011-2018	2011-2018	2011-2018	2011-2018	2011-2018	2011-2018	2011-2018	2011-2018	2011-2018
Baltic3	3.6	-1.0	-0.2	37.5	11.9	29.3	54.6	50.7	35.9	20.7	-0.2	44.5
CE4	2.6	-2.7	-0.4	43.9	15.5	53.1	53.5	41.4	33.9	13.2	0.1	38.9
SE3	2.5	-2.3	0.1	40.2	13.4	45.4	48.1	43.9	32.3	21.9	0.0	55.1
Hungary	2.7	-2.7	1.3	48.9	15.2	76.0	50.0	45.5	32.0	14.3	2.0	42.1

Source: Eurostat, European Commission Ameco Database, ILO. Notes: Baltic3 stands for the unweighted arithmetic average of Estonia, Latvia and Lithuania, CE4 for the unweighted arithmetic average of the Czech Republic, Poland, Slovakia and Slovenia, and SE3 for the unweighted

arithmetic average of Bulgaria, Croatia and Romania. Pre-2010 time ranges depend on data availability. Reported figures are unweighted arithmetic averages of annual data.

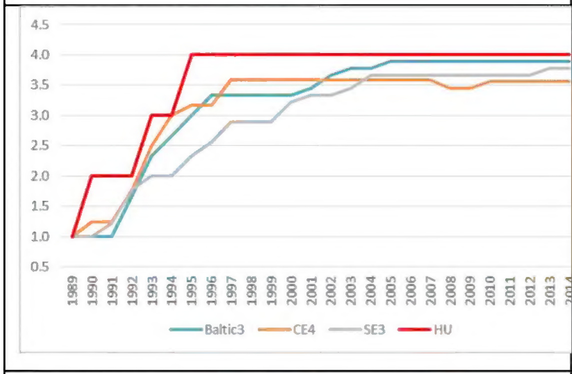
Figures 1-4. Average number of parliamentary parties and average number of new parliamentary parties in CEE; Gallagher indices in CEE, worldwide and in Hungary

1. Average number of parliamentary parties and average number of new parliamentary parties in 1990-2019 in CEE	2. Average Gallagher index of CEE countries in 1990-2016
	
3. Highest average Gallagher indices worldwide in 1990-2016	4. The Hungarian Gallagher index in 1990-2016
	

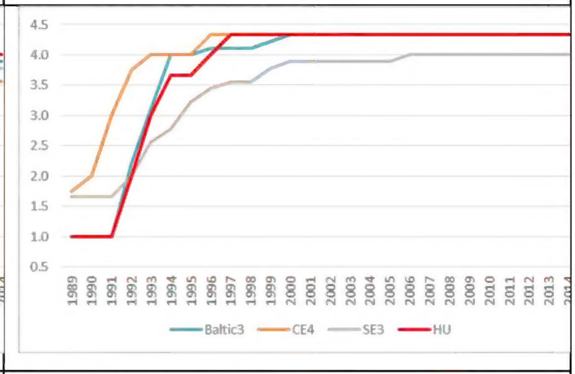
Source: National governments and electoral authorities, Democracy Barometer (http://www.democracybarometer.org/)

Figures 5-10. EBRD Transition Indices

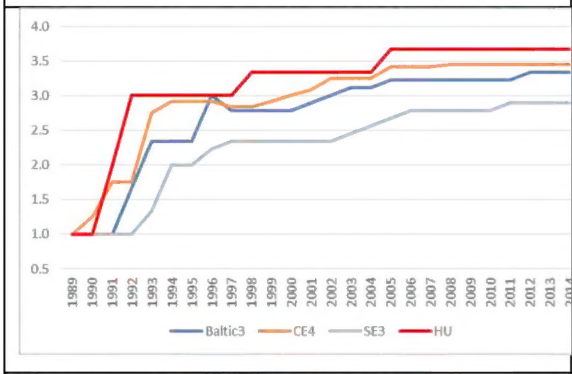
5. Large scale privatization



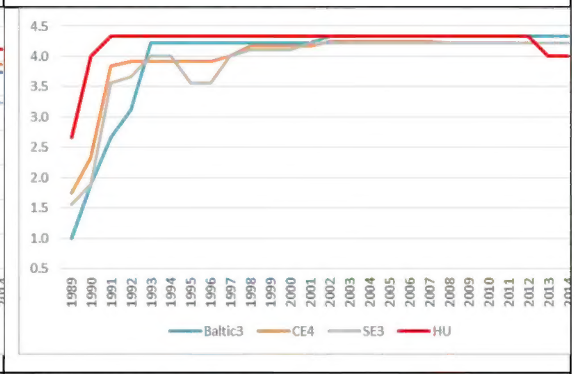
6. Small scale privatization



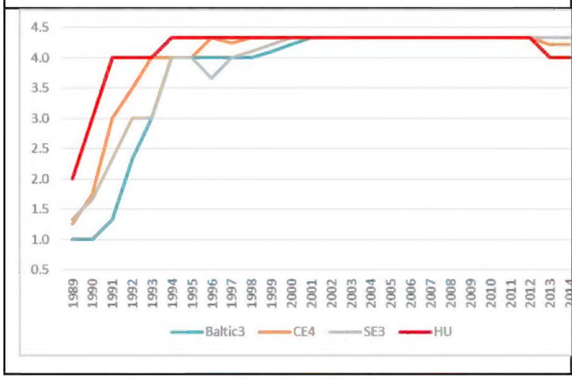
7. Governance and enterprise restructuring



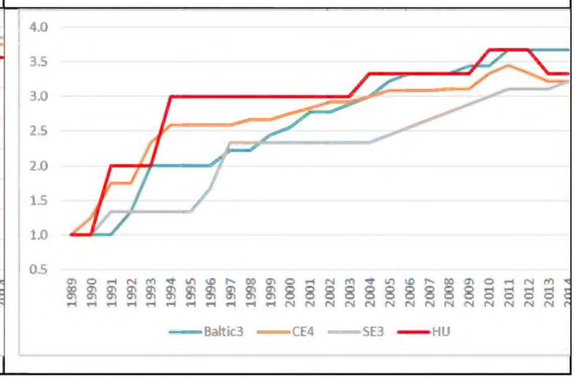
8. Price liberalization



9. Trade and foreign exchange system



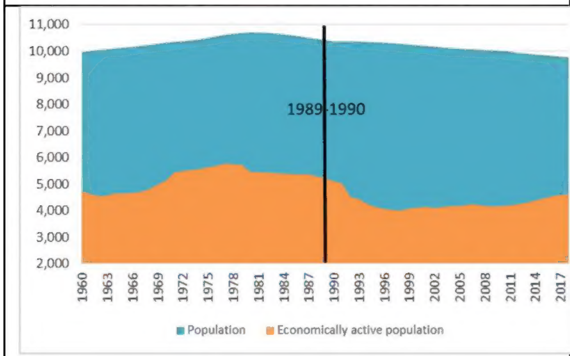
10. Competition policy



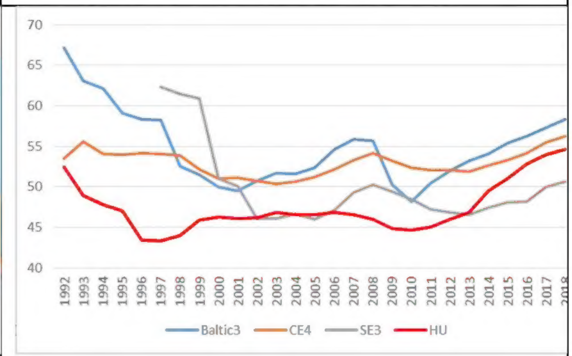
Source: European Bank for Reconstruction and Development

Figures 11-14. Employment and economic activity rates in Hungary and CEE; Total general government expenditure and expenditure on social protection in CEE

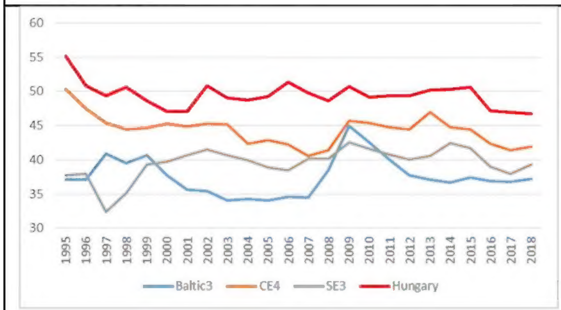
11. Population and economically active population in Hungary (in thousand people)



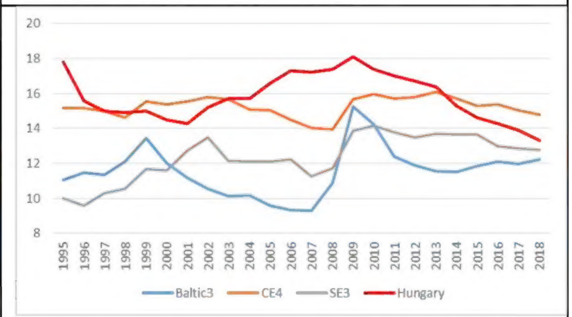
12. Employment rate in Hungary and CEE (in percent of total active-age population)



13. Total general government expenditure in CEE (in % of GDP)



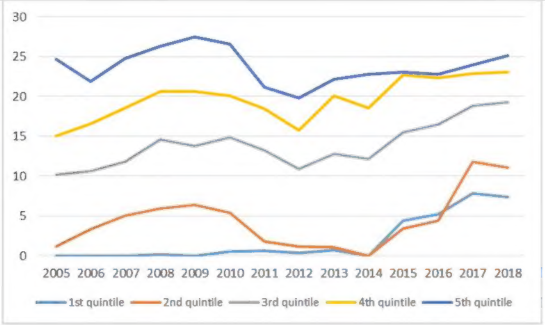
14. General government expenditure on social protection in CEE (in % of GDP)



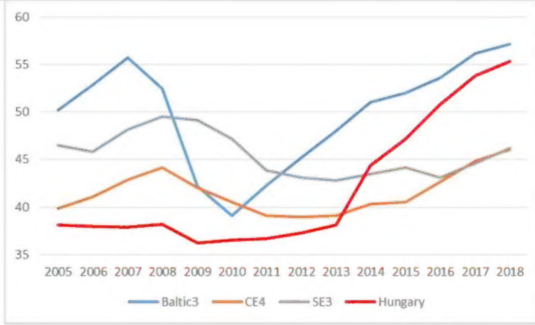
Sources: Hungarian Central Statistical Office, ILO (based on Eurostat & OECD data), Eurostat

Figures 15-18. Direct taxation of households in Hungary, employment of unskilled labor, Gini coefficients, and at risk poverty rates in CEE

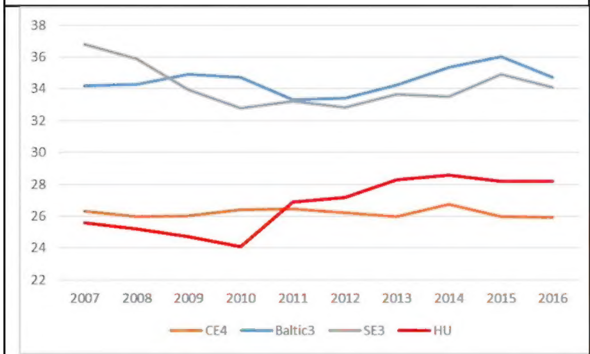
15. Direct taxation of households as a percentage of gross income by income quintiles in Hungary



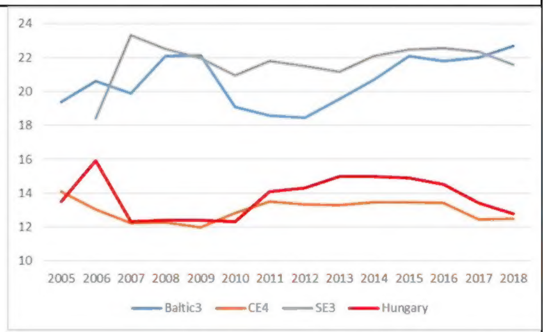
16. Employment rate of those with lower secondary education and below (% of 15-64 years old)



17. Gini coefficients



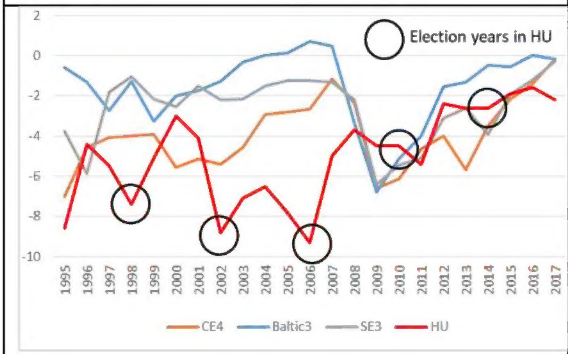
18. At risk of poverty rates (cut-off point: 60% of median equivalised income after social transfers)



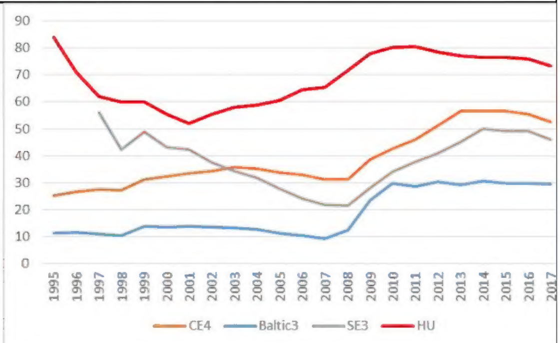
Source: Eurostat experimental statistics [icw_tax_06], Eurostat

Figures 19-24. General government balance and public debt in CEE, monetary conditions in Hungary, net financing capacity, economic growth and investment growth in CEE

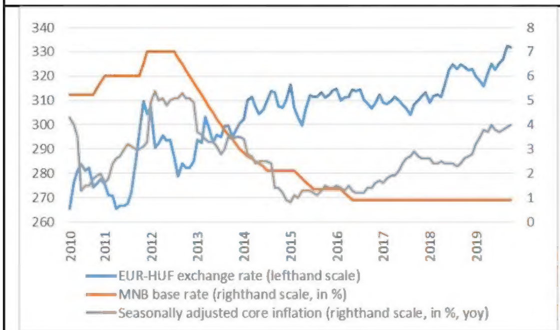
19. General government balance (in percent of GDP)



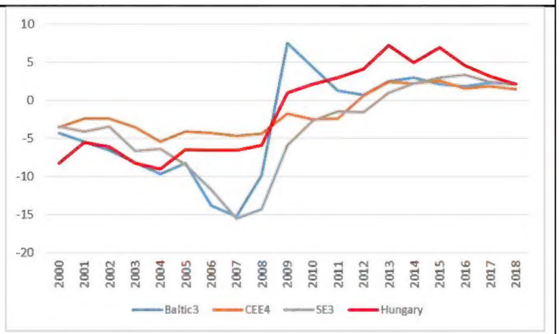
20. Public debt (in percent of GDP)



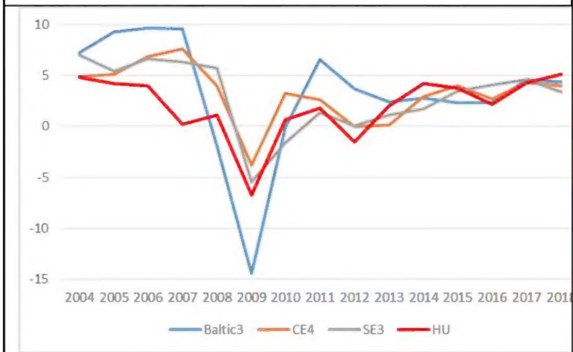
21. Euro-forint exchange rate, MNB base rate (the key policy rate) and core inflation in Hungary



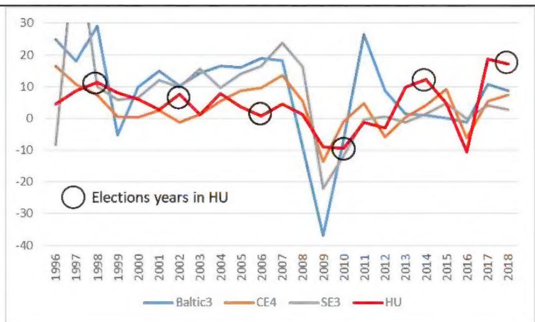
22. Current and capital accounts (i.e. net financing capacity, against rest of the world, in % of GDP)



23. GDP growth (percentage change over previous year)



24. Growth in gross fixed capital formation (percentage change over previous year)



Source: Eurostat, Magyar Nemzeti Bank (MNB)